



# ARIZONA STATE RETIREMENT SYSTEM

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*Paul Matson*  
Director

## MINUTES PUBLIC MEETING ARIZONA STATE RETIREMENT SYSTEM BOARD

Friday, January 29, 2016  
8:30 a.m., MST

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. Kevin McCarthy, Chair of the ASRS Board, called the meeting to order at 8:30 a.m., Arizona Time.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

### 1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Kevin McCarthy, Chair  
Mr. Jeff Tyne, Vice Chair  
Mr. Clark Partridge  
Professor Dennis Hoffman  
Mr. Lorenzo Romero  
Dr. Richard Jacob  
Mr. Robert Wadsworth (joined via teleconference at 8:45 a.m.)  
Mr. Tom Connelly (via teleconference)  
Mr. Tom Manos

A quorum was present for the purpose of conducting business.

Mr. McCarthy took a moment to welcome Mr. Lorenzo Romero, the newest Board member.

### 2. Approval of the Minutes of the December 4, 2015 Public Meeting and Executive Session of the ASRS Board

**Motion:** Mr. Jeff Tyne moved to approve the Minutes of the December 4, 2015 Public Meeting and Executive Session of the ASRS Board. Prof. Dennis Hoffman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

### 3. Approval, Modification, or Rejection of Recommended Administrative Law Judge's Decision Regarding Mr. Donald Smith's Appeal of a Domestic Relations Order

Ms. Jothi Beljan, Assistant Attorney General, confirmed Mr. Donald Smith was not present and provided a summary of the appeal to the Board and the ASRS' position. Mr. Smith's appeal

involves a factual dispute of the implementation of a Domestic Relations Order (DRO). The DRO stated the specific numerator which included service credit transferred from the Public Safety Personnel Retirement System (PSPRS) but only defined the denominator by stating, "is the number of full months the Participant participated in the Plan as of the date of Participant's commencement of benefits from the Plan." Per the DRO, when calculating the denominator, the ASRS did not include service credit transferred from the PSPRS based on the language in the DRO. Mr. Smith has indicated that the intent of the DRO was for the denominator and the numerator to be the same although that is not how the DRO was written. Ms. Beljan stated the ASRS is required to implement the DRO as written.

**Motion:** Mr. Clark Partridge moved to accept the Administrative Law Judge's Decision. Prof. Dennis Hoffman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

#### **4. Approval, Modification, or Rejection of Recommended Administrative Law Judge's Decision Regarding Ms. Amy Smith's Appeal of an Overpayment**

Ms. Amy Smith was present via teleconference.

Ms. Jothi Beljan provided a summary of the appeal for the Board and the ASRS' position. Ms. Smith was employed with Maricopa Integrated Health System (MIHS) on a part-time basis. Through the course of a self-audit by MIHS in June 2014, it was discovered MIHS incorrectly remitted contributions on behalf of Ms. Smith from August 2010 to October 2010, because she did not meet ASRS membership requirements under A.R.S. § 38-711(23)(b). MIHS requested a return of those contributions under A.R.S. § 38-738(A) which the ASRS provided. MIHS would then return the employee contributions to Ms. Smith as wages. Also in June 2014, Ms. Smith submitted an application for refund of contributions, resulting in the ASRS unknowingly making an overpayment due to the error later discovered by MIHS. The ASRS is required to collect the overpayment from Ms. Smith under A.R.S. § 38-765.

Ms. Smith was provided an opportunity to present her position. She advised the Board that when she began her employment with MIHS in August 2010, she made contributions to the ASRS as this was her second employment with an ASRS employer. In 2014, Ms. Smith made the decision to consolidate all of her retirement accounts into one IRA which is why she submitted her application for refund of contributions. Ms. Smith stated that since she rolled over her contributions into an IRA she did not have the ability to pay the ASRS the full amount requested of \$2,136.56. Instead, Ms. Smith offered to pay the ASRS \$1,707.73, the after-tax amount refunded to her by MIHS and feels the ASRS should be seeking restitution of the remaining balance from MIHS since this was their error and not hers.

Mr. Kevin McCarthy expressed the Board is sympathetic to the position in which Ms. Smith has been placed in but the Board is bound by the Arizona Revised Statutes as it pertains to the requirement to collect overpayments of contributions.

Mr. Tom Manos stated for the record that although Ms. Smith referred to MIHS as the County Hospital, Maricopa County divested itself of the hospital in 2005. Mr. Manos further stated that if MIHS was a county hospital, he would recuse himself from any votes on the matter but since that is not the case, he does not feel the need to do so.

Prior to making a motion, Mr. Jeff Tyne added this is an unfortunate set of circumstances and he also sympathizes with the situation Ms. Smith is in; however, the law clearly dictates what is required when an overpayment occurs.

**Motion:** Mr. Jeff Tyne moved to accept the Administrative Law Judge's Decision. Dr. Richard Jacob seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

*Mr. Robert Wadsworth joined the meeting at 8:45 a.m. and participated in the vote.*

## **5. Presentation, Discussion, and Appropriate Action Regarding the ASRS Proposed Legislation for the 2016 Legislative Session**

Mr. Patrick Klein, Assistant Director, External Affairs Division, and Mr. Nick Ponder, Government Relations Officer, provided a brief update to the Board regarding the 2016 Legislative agenda.

The following bills were discussed:

- **HB2104: ASRS; Retention of Credited Service** – This is a clean-up bill to HB2050 from 2014, that removed the Social Security Administration Section 218 Agreement as a requirement for participation in the ASRS. The ASRS needs to seek approval from the Internal Revenue Service (IRS), for individuals who are currently in our plan but who may not be eligible to be in our plan, in order to maintain their credited service. The ASRS received approval from the IRS and this bill contains the language required to grandfather this group into the ASRS. This bill contains an emergency clause because it needs to be effective prior to August 31, 2016, in the event the legislative session doesn't close by May 31, 2016. This bill passed through the Government and Higher Education Committee January 21, 2016.
- **HB2159: ASRS; Rulemaking Exemption** – The ASRS is requesting an exemption from rulemaking for the purposes of actuarial assumptions and calculations, investment strategy and decisions, and accounting methodology. The bill was assigned to the Government and Higher Education Committee this week and is on the February 4, 2016, meeting agenda.
- **HB2160: ASRS; Eligible Rollovers** – This bill eliminates indirect rollovers as an option for payment of service purchase. This bill passed through the Government and Higher Education Committee January 28, 2016.
- **HB2243: ASRS; LTD Program; Liability** – This bill protects the ASRS from “bad faith” claims relating to the denial of benefits, similar to ERISA plans. This bill passed through the Government and Higher Education Committee January 28, 2016.
- **SB1037: ASRS; Board Delegation; Benefit Determinations** – This bill allows the ASRS Board to assign a Committee of the Board for the purposes of determinations on appealable agency actions, granting full legal authority of the Board to the Committee of the Board to accept, reject, or modify a determination of the Administrative Law Judge, including requests for rehearing. This bill passed through the Senate Finance Committee January 27, 2016, passed through the full Senate January 28, 2016, and is ready to move to the House.
- **SB1038: ASRS; Reinstatement; Contribution Amount** – This bill clarifies the language as it relates to a member who withdrew contributions and the ex-spouse received a portion of the contributions through a Domestic Relations Order (DRO). If a

member wishes to reinstate past service credits, the member must repay the total amount in order to receive the full amount of service credit, not only the portion received by the member. This bill passed through the Senate Finance Committee January 20, 2016 and is scheduled for a full Senate vote on February 1, 2016.

- **SB1144: ASRS; Contributions; Adjustments** – This bill modifies language to A.R.S. § 38-738(A) & (B) to ensure compliance with the Internal Revenue Code. This bill passed through the Senate Finance Committee January 27, 2016, and is scheduled for a full Senate vote on February 1, 2016.

The following are bills that affect the ASRS but not initiated by the ASRS:

- **SB1151: ASRS; Continuation** – This bill relates to the statutory life of the ASRS and extends it for eight years to July 1, 2024. This bill passed the Senate Finance Committee January 27, 2016 and scheduled for a full Senate vote on February 1, 2016.
- **HB2115: Public Employees; Misappropriation; Penalty** – This bill has been assigned to the Government and Higher Education Committee and if passed, provides that an individual who misappropriates public monies would not be eligible to receive a pension benefit that would have been provided by the agency.
- **HB2157: ASRS; Political Subdivision Entities** – This bill has been assigned to the Government and Higher Education Committee and if passed, would exclude membership in the ASRS of new employees of political subdivision entities. Employees who are currently members of the ASRS and become employed with a political subdivision entity will maintain their membership in the ASRS. The ASRS has identified 15 employers that would be impacted by this bill.
- **HB2237: Retirement; Return to Work; Restrictions** – This bill has not yet been assigned to a Committee. If passed, this bill would prohibit a retiree from returning to work either directly through the employer or through a leasing company for 365 days from the date of retirement.
- **HCR2040: State Monies; Prohibited Investments; Terrorism** – This is a Constitutional amendment that would preclude any state, public retirement systems, counties, municipalities and other political subdivisions from contracting with or investing in any legal entity that is invested in or doing business with the government of a country that is designated by the U.S. Department of State on or after January 1, 2015, as a state sponsor of terrorism. The three countries currently on the list are Syria, Sudan and Iran.

Mr. Ponder closed by advising the Board he is waiting for the Public Safety Personnel Retirement System (PSPRS) language modifications. Senator Lesko has been organizing a pension review committee to make some modifications to the PSPRS plan. The bill numbers were assigned late January 28, 2016, but the language has not been posted on the website yet in order for Mr. Ponder to provide a better summary of what is being proposed. It is Mr. Ponder's belief that none of the PSPRS bills will have an effect on the ASRS.

**6. Presentation, Discussion, and Appropriate Action Regarding Proposed Modifications to the Existing ASRS Plan and Long Term Disability (LTD) Strategic Investment Policies (SIPs), Approval of Newly Created SIPs for the ASRS System and the Proposed Strategic Asset Allocation for LTD and System**

Mr. Paul Matson, Director, presented this topic to the Board with Mr. Gary Dokes, Chief Investment Officer. Ms. Lupita Breland, Portfolio Analyst and Mr. Micheal Copeland, Investment Analyst, were also available to respond to any questions from the Board.

Mr. Matson reviewed the following:

- Proposed policy modifications pertaining to the Asset Allocation and Tactical Positioning and Rebalancing for the Plan and LTD to make them clearer.
- Proposal to establish new policies pertaining to the System's Asset Allocation and Tactical Positioning and Rebalancing.
- Proposed Strategic Asset Allocation for LTD and System, similar to those approved by the Board for the Plan in 2015.

Mr. Matson opened up the discussion to questions from the Board. There were no questions.

**Motion:** Mr. Tom Connelly moved to 1) Approve modifications to the existing Strategic Investment Policies (SIPs) 001, 002, 003, and 004 pertaining to the Asset Allocation and Tactical Positioning and Rebalancing SIPs for the Plan and LTD, as recommended by the Investment Committee (IC) at the November 30, 2015 meeting; 2) Approve two new SIPs pertaining to System's Asset Allocation and Tactical Positioning and Rebalancing, as recommended by the IC at the November 30, 2015 meeting; and 3) Approve the proposed SAA for LTD & System, as recommended by the IC at the April 13, 2015 meeting. The proposed changes reflect an allocation to asset classes similar to those of the Board approved Plan Strategic Asset Allocation (SAA) Policy on March 27, 2015.

Prof. Dennis Hoffman seconded the motion adding the following amendments to 1) as presented in Appendix I of this agenda item; 2) as presented in Appendix I of this agenda item; and 3) as presented in Appendix II of this agenda item.

Dr. Richard Jacob seconded the amendments.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

## **7. Presentation, Discussion, and Appropriate Action Regarding an Annual Update on Strategic Plan Priority #2 in the ASRS 5-Year Strategic Plan: Optimize Risk Management**

Mr. Anthony Guarino, Deputy Director and Chief Operations Officer, introduced this topic stating that risk management has been an agency priority since 2013 when the Strategic Plan was updated. The Board has tasked Management with implementing a risk management program that incorporates best practices, providing the Board with some assurance that staff is taking the appropriate steps to minimize risks. Overall, Mr. Guarino feels the ASRS is succeeding and staff's outlook is generally positive, which he said the report will reflect. Mr. Guarino added, the ASRS has adopted the principles of the Committee of Sponsoring Organizations of the Treadway Commission and has organized a permanent standing committee of Senior and Executive Managers who meet weekly, flagging potential risk events, assessing controls and developing remediation strategies when needed. Mr. Guarino turned the discussion over to Ms. Lisa King, Policy Analyst, to provide a summary of the report.

Ms. King reviewed the following report highlights:

- **Investment Management and Volatility:** Management Outlook is Neutral to Positive – The ASRS recognizes there are risks and vulnerabilities but they have been manageable and the agency is continuing to strengthen controls.
  - The risk assessment conducted identified 30 risks. The overall conclusion is the agency has controls in place that mitigate those risks within the agencies risk tolerance.
  - Additional controls have been implemented since the risk assessment was completed.
  - The Office of the Auditor General's (OAG) Sunset Review "found that the current practices and procedures are reasonably consistent with industry standards and generally in line with many best practices." There were a few recommendations from the OAG the ASRS has agreed with and will implement as appropriate.
- **Data and System Security:** Management Outlook is Neutral to Positive – For the same reasons as the previous item. The agency is developing a framework that conforms to the National Institute of Standards and Technology standards for information security.
  - A life cycle has been developed to conducted assessments. Every other year the agency brings in an external consultant to perform a penetration assessment. Once the assessment is completed, an internal risk assessment is completed. In the years the external consultant is not performing assessments, the agency's Internal Audit Division is performing a security audit.
  - Results of the 2014 risk assessment found the ASRS has controls in place for all 19 zones. The agency set an aim to increase security maturity level in 12 of the 19 zones.
  - The OAG Sunset Review originally reviewed the agencies information technology practices March 2014, provided some recommendations and came back a little more than a year later to re-review. What the OAG found is the ASRS was taking action to improve all areas the OAG identified and fully addressed the OAG's concerns in the area of encryption. The ASRS has concurred with and will implement the remaining OAG recommendations.
- **Agency Effectiveness and Efficiency:** Management Outlook is Neutral to Positive – Operations rely on the strategic planning model which sets the agency's specific objectives and performance targets. The agency measures and reports on those regularly.
  - Effectiveness and efficiency are reviewed in the agency's risk assessments. Numerous controls and metrics are in place but the agency recognizes that it has some vulnerabilities.
  - CEM Benchmarking is used as an external source to measure the agency's performance against its peers. The aim is to be high performing and cost effective. While the CEM data is positive, CEM has identified some areas where improvement can be made and the ASRS is currently moving towards making those improvements.
- **Customer Service and Satisfaction:** Management Outlook is Neutral to Positive – For the same reason as the previous item.
  - The ASRS has strong controls in place to measure member satisfaction and reports on these regularly.
  - Based on a recent survey, the area in need of strengthening the controls is in measuring employer satisfaction.

- The Employer Services Division has been reorganized and the agency is in the process of developing employer customer service measures.
- **Diminished Independence and Autonomy:** Management Outlook is Neutral to Positive – The agency has determined that the operational capacity depends on adequate funding, qualified staff, and modern technology. To date, these constraints have not proven to be enough of an impediment to recommend a change at this time.
  - The OAG Sunset Review has determined that the ASRS met its statutory objective and purpose and that terminating the ASRS would significantly harm the public welfare. The OAG issued supplemental reports after the performance report, with one report citing some research supporting the allowance of public retirement systems to establish their own budgets, procurement rules and personnel rules. The ASRS does not currently have independence in all of these areas.
  - The ASRS will continue to use its risk assessments to evaluate how the agency is impacted by the current level of independence and autonomy.
- **Contribution Rate Volatility:** Management Outlook is Neutral to Positive
  - The OAG found that the ASRS has controls in place to mitigate against contribution rate volatility but additional measures can be taken.
  - The ASRS established a funding policy in 2015 to address many of the OAG's concerns.
- **Benefit Spiking:** Management Outlook is Neutral to Positive – The ASRS has done research and found very few instances of benefit spiking. The impact of this appears to be minimal; however, the agency will continue to monitor this.
  - The OAG recommended procedure enhancements to identify employer termination incentive programs and assess the associated costs of any unfunded liability to the appropriate employer. The ASRS concurs and is currently working on implementing this.

## **8. Presentation and Discussion Regarding the Board Self-Evaluation Material Distribution to be Reviewed at the February 26, 2016 Meeting**

Mr. McCarthy addressed the Board regarding the Board self-evaluation material, noting Trustees should submit their Board performance evaluation forms to him prior to the February Board meeting, allowing enough time for staff to prepare a summary of the responses.

## **9. Presentation, Discussion, and Appropriate Action Regarding the Director's Report as well as Current Events**

Mr. Paul Matson made two announcements:

- The Long Term Disability contract is soon to expire. An RFP has been issued with the pre-bid conference taking place on February 1, 2016.
- The ASRS Tucson Office will be moving. The tentative date is February 16, 2016.

Mr. Matson responded to Prof. Dennis Hoffman's request to provide an update on the fiscal year-to-date investment returns, indicating it is approximately -6%, from June 30, 2015 (close of business) to current.

## **10. Presentation and Discussion with Respect to Informational Updates from Prior and Upcoming Committee Meetings**

### **a. Operations and Audit Committee (OAC)**

Mr. Jeff Tyne announced the next OAC meeting will be held on February 9, 2016 at 10:30 a.m. in the 14<sup>th</sup> floor conference room to discuss the contracts and procurement risk assessment, recently conducted audits and the quarterly internal audit report.

### **b. External Affairs Committee (EAC)**

Dr. Richard Jacob announced the next EAC meeting will be held on February 12, 2016 at 10:30 a.m. in the 14<sup>th</sup> floor conference room to discuss updates on legislation.

### **c. Investment Committee (IC)**

Mr. Tom Connelly announced the next IC meeting will be held on February 22, 2016 at 2:30 p.m. in the 14<sup>th</sup> floor conference room to review investment program updates, program oversight and the fourth quarter performance report.

## **11. Board Requests for Agenda Items**

No requests were made.

## **12. Call to the Public**

A member of the public, Ms. Deborah Gregor, requested to address the Board regarding a personal experience she is currently encountering which she believes could affect her ASRS account. Ms. Gregor advised the Board she doesn't know how to approach the issue or what she can do legally and asked for assistance.

Ms. Jothi Beljan reminded the Board that when a public member addresses the body that the Board can speak on the subject if it has been noticed on the agenda, the Board may ask an ASRS staff member to follow up with the public member or the Board may respond to criticism. In this case, Ms. Beljan recommended that the Board assign a staff member to discuss the matter with Ms. Gregor and Ms. Beljan could also provide contact information to the Attorney General Consumer Fraud Section to the public member after the meeting. Ms. Beljan added that the ASRS has very high security on its member accounts, there is a fraud officer at the ASRS that members can contact if there is an issue, and as far as any individual getting to an individual's ASRS account, there are only three legally identified types of attachments to an account: a federal tax levy or lien, a child support order, and a Domestic Relations Order. Ms. Beljan concluded there is no other way an individual can access an ASRS member's account.

Mr. Paul Matson announced that the police officer in attendance in the meeting has offered to meet with Ms. Gregor, along with Mr. Anthony Guarino, to discuss the issue. Ms. Gregor was agreeable to the offer.

## **13. The next regular ASRS Board meeting is scheduled for Friday, February 26, 2016, at 8:30 a.m., at 3300 N. Central Avenue, 10<sup>th</sup> Floor Board Room, Phoenix, Arizona.**



#### **14. Presentation, Discussion, and Appropriate Action Regarding the review of the Director and Employment Contract for the Director**

**Motion:** Mr. Clark Partridge moved to go into Executive Session for the purpose of the Director's review and employment contract. Mr. Tom Manos seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

The Board convened to Executive Session at 10:27 a.m.

*Mr. Clark Partridge and Mr. Lorenzo Romero left the executive session at 10:50 a.m.*

The Board reconvened to Public Session at 10:57 a.m.

**Motion:** Mr. Tom Manos moved to approve the Employment Contract for the ASRS Director, Mr. Paul Matson, with amended language to be added to the last sentence in paragraph 3. b., to read, "All remaining base salary for the remainder of the fiscal year would be fully payable." Once amended, the contract will be provided to the Board secretary. Dr. Richard Jacob seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, and 3 excused, the motion was approved.

*The record should reflect the response of Mr. Robert Wadsworth, who was attending via teleconference, was momentarily delayed and he has confirmed that his vote was in favor of the motion and is reflected in the above results.*

*Mr. Tom Connelly experienced technical difficulty attempting to call back into the public session and was unable to participate in the vote. Mr. Connelly requested the record to reflect that had he been able to participate in the vote, he would have voted in favor of the motion.*

#### **15. Adjournment of the ASRS Board**

**Motion:** Dr. Richard Jacob moved to adjourn the January 29, 2016 Board Meeting at 10:58 a.m. Mr. Jeff Tyne seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, and 3 excused, the motion was approved.

ARIZONA STATE RETIREMENT SYSTEM

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Melanie A. Alexander  
Board Administrator

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Paul Matson  
Director